(1) Supreme Court, U.S.

No.

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 2001

STATE ENGINEERING ASSOCIATION, *et al.*

Petitioners,

vs.

GEORGE LIGHTBOURN, Acting Secretary of the Wisconsin Department of Administration, *et al.*

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of the State of Wisconsin

PETITION FOR WRIT OF CERTIORARI

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38p.

QUESTIONS PRESENTED

1) Whether the assets and earnings of the Wisconsin Retirement System are the "private property" of participants in the Wisconsin Retirement System for purposes of the Takings Clause of the Fifth and Fourteenth Amendments to the United States Constitution.

2) Whether the judicial abandonment or recasting of well established private property rights, properly voids the Constitutional protections of the Fifth and Fourteenth Amendments to the United States Constitution as to the taking of such private property without just compensation and without due process of law.

3) Whether the challenged provisions of 1999 Wisconsin Act 11 take the private property of participants in the Wisconsin Retirement System without just compensation and without due process of law.

4) Whether the challenged provisions of 1999 Wisconsin Act 11 impair the contract between participants and the State of Wisconsin in violation of Article I, § 10 of the United States Constitution.

LIST OF PARTIES

The Petitioners to the original action before the Supreme Court of the State of Wisconsin were: the State Engineering Association, by its President, Thomas H. Miller, David Buschkopf, Ross Johnson, Melvin Sensenbrenner, Bernard Kranz and Thomas H. Miller (Petitioners herein); and the Wisconsin Professional Police Association, Inc., John Charewicz, David Mahoney, Susan Armagost, and Steven Urso (Collectively, "WPPA"). The Respondents in the original action were: George Lightbourn, Acting Secretary of the Wisconsin Department of Administration, Jack C. Voight, Wisconsin State Treasurer (collectively, "State Respondents"); and the Wisconsin Education Association Council, by its President, Terry Craney and its Vice-President, Stan Johnson, and Donald Krahn, Margaret Guertler, Gerald Martin, and Phyllis Pope (Collectively, "WEAC Respondents").

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Public Employee Pensions in Times of Fiscal Distress, Harv.L.Rev. 992, (1977) 14

OPINIONS BELOW

The Opinion of the Wisconsin Supreme Court is reported at 2001 WI 59, 627 N.W.2d 807 (2001), *motion for reconsideration denied*, 2001 WI 114 (July 18, 2001). App. 1, 100. This was an original action before the Wisconsin Supreme Court.

JURISDICTION

The Wisconsin Supreme Court decision was issued June 12, 2001; a timely Motion for Reconsideration was filed July 2, 2001. Reconsideration was denied on July 18, 2001.[1] The jurisdiction of this Court is invoked under 28 U.S.C. § 1257.

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

The Fifth Amendment to the United States Constitution provides, in relevant part, that "No person shall be ... deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." The Fourteenth Amendment to the United States Constitution provides, in relevant part, "nor shall any State deprive any person of life, liberty, or property, without due process of law." Article I, § 10 of the United States Constitution provides in relevant part that "No state shall ... pass any ... law impairing the obligation of contracts...."

Relevant statutory provisions, including Sections

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[1]The Motion for Reconsideration was filed pursuant to § 809.64, Stats. which replaces former Rules 251.65, 251.67 to 251.69, which provided for motions for rehearing. ... The term "reconsideration" is used because in cases decided without oral argument there has been no initial hearing. Section 809.64, Wis. St. Ann.

27(1)(a) and (1)(b)1 of 1999 Wisconsin Act 11, and Wisconsin Statute §§ 40.01, 40.015, 40.02(7), 40.02(23)(a), 40.03(1), 40.04(3)-(6), 40.05, 40.19(1), 40.23(2m)(b) and (e), are lengthy, and are therefore included in Petitioner's Appendix pursuant to S.Ct. Rule 14.1(f).

STATEMENT OF THE CASE

The present action was heard by the Wisconsin Supreme Court, exercising original jurisdiction, on a record comprised of stipulated facts and exhibits. Relevant facts and exhibits are included in Petitioners' Appendix and cited herein as "App. __".

Petitioners include "Participants" in the Wisconsin Retirement System (the "WRS"), "Annuitants", and a labor organization representing Participants. App. 229-30. Petitioners challenged the constitutionality of a number of provisions of Wisconsin Assembly Bill 495 (1999 Wisconsin Act 11, hereinafter, "Act 11"). This Petition seeks review of portions of the Wisconsin Supreme Court's decision holding that Sections 27(1)(a) and (1)(b)1 of Act 11 are constitutional, and do not take the private property of WRS Participants/Annuitants for a public purpose without just compensation and without due process of law in violation of the Fifth and Fourteenth Amendments to the United States Constitution or impair the contract rights of WRS Participants in violation of Article I, § 10 of the United States Constitution. App. 79-80.

The Federal questions herein were raised by Petitioners in their Complaint, briefs, and Motion for Reconsideration; such questions were both implicitly and explicitly addressed in the Wisconsin Supreme Court's decision. App. 78-79, 80-81, 194, 209, 224-25, 226. *See, also,* App. 60 n. 180.

A. Summary of Procedural History and Decision.

1. The present action was commenced on December 22, 1999, when the fiduciaries of the WRS Trust Fund (the "Fiduciaries") filed a Petition for Leave to Commence an Original Action in the Wisconsin Supreme Court challenging the constitutionality of a number of sections of Act 11, and

seeking to have such unconstitutional provisions severed from the remaining portions of Act 11 prior to its implementation. App. 164. The relevant portions of the original Petition alleged that Sections 27(1)(a) and 27 (1)(b)1. of Act 11 violate the takings and contract clauses of the United States Constitution App. 184.

2. Motions to intervene by Petitioners, the WPPA, and the WEAC Respondents were granted by the Wisconsin Supreme Court. App. 34.

3. The sections of Act 11 at issue in this Petition direct that $200 million of WRS assets that would otherwise be used to purchase annuities for Participants be diverted to a credit account and used to pay financial obligations of participating employers. App. 29-30, 121-22. The sole purpose of the legislation was to provide the State of Wisconsin with budgetary relief. App. 75.

4. By Order dated February 10, 2000, the Wisconsin Supreme Court dismissed the Petition for leave to file an original action filed by the Fiduciaries, holding that all the Fiduciaries were either public officers or state agencies, and therefore, could not challenge the constitutionality of a duly enacted statute of the State of Wisconsin. The ETF Parties later filed a motion for leave to file an *amicus curiae* brief. Said motion was denied, thus depriving these fiduciaries of any ability to participate in this action in any capacity. App. 94-95 n. 1.[2]

5. The parties entered into a stipulation of facts which was submitted to the Wisconsin Supreme Court, which then posed certain additional questions to the parties including: what was each party's position as to whether the "Trust Fund, as changed

[2]In its decision, the Wisconsin Supreme Court stated: "...the ETF Board would stand as a bulwark of fiduciary responsibility to protect the security of the fund" from future larger legislative grabs at Trust Fund assets. The Court was silent as to how the ETF Board fiduciaries could protect any future legislative grab, given their inability to commence or to participate in litigation.

by the subject legislation, will be actuarially sound." App. 249.

6. All parties responded to the questions posed by the Wisconsin Supreme Court. The Petitioners herein responded, in relevant part, as follows:

> .... SEA's [(Petitioner's)] position on this point cannot be adequately answered with a "yes" or "no".
>
> The SEA Petitioners do not take the position that the provisions of AB 495, in and of themselves, leave the Trust Fund in a financially troubled condition, now or in the future. Notwithstanding this statement, the SEA Petitioners believe, and intend to argue, that AB 495 poses a systemic threat to the Trust Fund. If Trust Fund assets may be used to meet non-trust obligations, then the substantial assets of the Trust Fund are at risk for future legislative conversions that could threaten the solvency and actuarial soundness of the Trust Fund. The very ability to remove dollars from the Trust Fund either directly or indirectly, for purposes other than paying benefit commitments associated with those funds, poses a significant danger to the future and security of the Trust Fund. Whether this concern fits within the parameters of the term "actuarial soundness" can perhaps be argued, but SEA is concerned about stipulating to the use of a term without a clear definition of what that terms may mean under Wisconsin law.
>
> SEA Petitioners do not believe that the proper test under a takings analysis can be whether the Trust Fund remains able to meet its benefit commitments to Participants after a particular taking. Participants have a vested interest in their retirement system that extends to the WRS as a whole. Association of State Prosecutors v.

> Milwaukee County, 199 Wis. 2d 549, 558, 544 N.W.2d 888 (1996). An improper taking from the Trust Fund does not become legally appropriate if sufficient funds remain to pay the obligations and benefit commitments of the Trust Fund. Using the Trust Fund as a ready source of cash to meet the State's budgetary cash flow needs or as a fund from which employers are free to drain existing cash reserves is constitutionally flawed without regard to whether the remaining funds are sufficient to meet benefit commitments.

App. 250-51.

7. On May 25, 2000, the Court took original jurisdiction of the present case. App. 35. In its Order, the Court adopted the stipulated facts and exhibits submitted by the parties through Judge Barron, and added that the stipulation "shall be construed to include the finding that the Trust Fund, as changed by the subject legislation, will be actuarially sound subject to the qualification[s]" contained in the SEA Petitioners' letter quoted above. App. 135-36.

8. On June 12, 2001, the Wisconsin Supreme Court denied Petitioners' prayer for relief and declared the challenged sections of Act 11 to be constitutional. App. 91-92. In reaching its decision, the Wisconsin Supreme Court stated as follows:

> Once contributions enter the employer reserve, they no longer belong to employers and may not be reclaimed by employers. They are assigned to participants. Non-annuitant participants have the right to block improper diversions from the employer reserve and to protect the integrity and security of the employer reserve so that benefit commitments will be fulfilled. Non-annuitants have an individual property interest to the full extent of their benefit commitments.

***

> While the $200 million employer credit is likely to affect the balance in the employer reserve, we see no evidence that the credit here will damage the property interests of non-annuitant participants. It does not "take" their property. All money in the employer reserve remains in the reserve and will go toward funding future benefits. No non-annuitant participant will receive less from the employer reserve than Chapter 40 requires. Speculation about how benefits might be increased in the future does not outweigh the legislature's right to amend the provisions of Chapter 40 to reduce employer costs on a temporary basis, provided the WRS remains secure.

***

> [Petitioners'] argument[s] overlook[] the distinction between taking money out of a fund held in trust for participants, and suspending payment of money into a fund before the employers' property interest has transferred.

App. 79, 80.

9. Three of seven Justices dissented with regard to the constitutional propriety of the $200 million credit, finding it to be an unconstitutional taking of WRS Participants' property and contract rights. The Chief Justice wrote as follows:

> The monies held in the Employe Trust Fund (ETF) have been irrevocably placed in trust for the benefit of the retirement system participants, and the State cannot direct that such monies be used for non-ETF purposes. The $200 million employer contribution credit, as Justice Bablitch also explains, is a diversion of $200 million of ETF monies in which retirement system

participants have a protected property and contract right.

This diversion is an unlawful taking and an impairment of contract, as well as a violation of trust principles. The Wisconsin and federal constitutions do not allow the legislature to balance the state budget or shift resources among governmental entities by using assets belonging to the ETF. Promises to contribute to the fund are assets belonging to the ETF. As a result of the majority opinion, Wisconsin now unfortunately joins other states that have viewed their once-burgeoning pension funds as sources of budget relief.

App. 95.

Justice Bablitch wrote as follows:

I join the majority opinion with the exception of part IV.D. regarding the $200,000,000 credit given to employers. This credit is a forgiveness of a debt owed by employers to the Wisconsin retirement system (WRS). It is not the state's to forgive. The state is not the owner of this debt; the employees are. Accordingly, I respectfully dissent to this part of the majority opinion.

***

Prior to the legislation, state and municipal employers either owed or will owe $200,000,000 into the WRS. This legislation forgives this past and future debt. Accordingly, the WRS will have $200,000,000 fewer assets available to it when future employee benefits or contributions are considered.

This $200,000,000 of debt, past or future, is not the legislature's money to use to balance their

> budget, relieve property taxes, or the like. This money belongs to the employees.
>
> Is this an unconstitutional taking? Of course.
>
> ***
>
> There is now $200,000,000 less in the system than there would have been. That seems to be a taking under anybody's definition.
>
> This is woefully bad precedent. To allow the legislature to take assets from the retirement system which belongs to the employees and use it for a purpose other than the employees without so much as a "by your leave," which is of course what happened here, potentially opens the floodgates to great mischief. We have previously warned of the dangerousness of such precedent.
>
> ***
>
> No amount of words can paper over the end result here. The employers are $200,000,000 richer because they no longer have a $200,000,000 obligation; the employees are $200,000,000 poorer because they no longer have available to them, either now or in the future, that money for potential benefits. I respectfully dissent.

App. 92-94 (citations omitted).

10. The SEA Petitioners filed a Motion for Reconsideration which was denied by Order dated July 18, 2001. App. 100.

B. THE WISCONSIN RETIREMENT SYSTEM ("WRS")

1. Establishment and Purpose of the Wisconsin Retirement System — a Public Employee Trust Fund.

The Wisconsin Retirement System ("WRS") was established pursuant to Chapter 40, Stats. The WRS is funded through the public employe trust fund (hereinafter, "Trust Fund") created by § 40.01, Stats. App. 142.[3] The purpose of the Trust Fund is to aid public employees in protecting themselves and their beneficiaries against the financial hardships of old age, disability, death, illness and accident. App. 102, 142. The WRS is administered by the Department of Employe Trust Funds ("DETF") and its appointed secretary under the direction and supervision of the Employe Trust Funds Board ("ETF Board") and each member of the ETF Board is a trustee of the Trust Fund. App. 103, 142. There are approximately 1230 participating public employers, including state agencies, counties, cities, municipalities, school districts, etc.; ninety percent of all public employees in Wisconsin are covered by the WRS, totaling in excess of 243,000 employees. App. 270-72.

The purpose of the Trust Fund is codified in § 40.01(2), Stats., which provides in relevant part as follows:

> The public employe trust fund is a public trust and shall be managed, administered, invested, and otherwise dealt with **solely for the purpose of ensuring the fulfillment at the lowest possible cost of the benefit commitments to participants, as set forth in this chapter, and shall not be used for any other purpose**.

App. 102, 142 (emphasis added).

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[3]Unless otherwise noted, all statutory references are to the 1997-98 volumes of the Wisconsin Statutes.

2. The Fixed Retirement Investment Trust (FRIT) and Its Reserves and Accounts

Within the Trust Fund there is a fixed retirement investment trust ("FRIT") where funds to fulfill the purposes of the Trust Fund are deposited. App. 106, 149-52. Three of the reserves and one account within FRIT are of principal significance to understanding the effects of Act 11: (1) the employee accumulation reserve account; (2) the employer accumulation reserve account; (3) the annuity reserve account; and (4) the transaction amortization account. App. 106-07.

(a) The Employee Accumulation Reserve (Employee Reserve)

Employee required contributions are credited to the employee reserve, and each participant has a separate account reflecting contributions and investment earnings credited to each participant. App. 106, 152-56, As of Dec. 31, 1999 the employee reserve balance stood at approximately $10,962,298,421. App. 273.

(b) The Employer Accumulation Reserve (Employer Reserve)

The employer reserve is a single merged account into which all employer required contributions and investment earnings on those contributions are deposited on a pooled basis (no separate accounts). App. 106-07, 156-57. This is reflective of the fact that employers do not retain any legal or beneficial interest in such funds. App. 79. The employer reserve is used to fund annuities and in calculating necessary contributions. As of Dec. 31, 1999 the employer reserve balance stood at approximately $13,435,380,598. App. 107, 273.

(c) The Annuity Reserve

The annuity reserve is the account into which sufficient funds are transferred from the employer and employee reserves to fund specific annuities at the time of their inception. These amounts, together with future earnings, are used to fund

annuities. App. 106-07, 157, As of Dec. 31, 1999 the annuity reserve balance stood at approximately $16,496,442,528. App. 107, 273.

(d) The Transaction Amortization Account ("TAA").

The TAA, created by § 40.04(3), Stats., accounts for realized and unrealized gains and losses from the Fixed Retirement Investment Trust's investments. App. 106-07, 149-52. Each recognition of earnings from the TAA is distributed pro rata to the other FRIT reserves and accounts. App. 108, 109, 150. By stretching the realization of investment gains and losses, the TAA tends to stabilize necessary contribution rates. As of Dec. 31, 1999 the TAA balance stood at approximately $13,910,154,943. App. 107, 273.

3. Employer and Employee Contributions and Unfunded Prior Service Liability

(a) Employee Required Contributions

Employee required contributions to the Trust Fund are comprised of essentially two components: (1) the basic required contributions set by statute as a percentage of a participating employee's earnings; and (2) benefit adjustment contributions necessary to maintain the financial balance of the WRS (changes in contribution rates are apportioned equally between the employer-required contribution rate and the benefit adjustment contribution rate). Thus, subsequent changes to contribution rates are split evenly between employers and employees. App. 111.

(b) Employer Required Contributions

Employer required contributions consist of essentially two components: (1) current service contribution rates, are assessed against all participating employers. The WRS consulting actuary annually evaluates the funding requirements for the WRS. The employer annual contribution rate is calculated to meet the costs of estimated future retirement

benefits for Participants ("normal costs"), net of all revenues received from the statutory employee required contributions, the benefit adjustment contributions and those investment earnings credited as current income. Such contribution rates, upon ETF Board approval, become effective each January and represent the routine employer contribution requirements for the WRS. App. 112; (2) employer obligations for unfunded prior service liabilities ("unfunded liability"). App. 114, 157. An employer's unfunded liability is the result of an employer electing to grant WRS service credits to its employees for services rendered by the employees before the employer joined the WRS as a participating employer. Elections to provide such prior service credits result in unfunded liability debt owed by the employer to the WRS. These unfunded liabilities increase when improvements in WRS retirement benefits are authorized and made applicable to prior service credits. App. 114.

Employer contribution rates for the payment of unfunded liability are amortized over 40 years. An employer must continue to make contributions toward its unfunded liability, plus interest at the assumed rate (§ 40.05(2)(b), Stats.), until the entire debt has been paid to the WRS. App. 114-15, 157-58. Wisconsin's Attorney General has concluded that there is no statutory authority for the ETF Board to adjust employer unfunded liability balances based on subsequent changes in the actuarial assumptions used to calculate employer contribution rates. App. 235-47. Wisconsin Statutes specifically authorize employers to pay-off their unfunded liability in advance. App. 114-15, 157-58.

4. WRS Retirement Benefits

The WRS provides two retirement plan options: the formula benefit retirement plan, (a defined benefit plan), and the money purchase retirement plan, (a defined contribution plan). Both types of benefits are calculated and Participants are entitled to receive the greater of the two. App. 103-04, 160.

C. ACT 11 CHANGES TO WRS

1. $4 Billion Recognized from the TAA

Act 11 provides that $4 billion from the TAA is to be recognized and distributed to the other FRIT reserves and accounts on a pro-rata basis. Accordingly, most of the $4 billion is distributed to the employer, employe and annuity reserves. App. 121-22, 137.

2. Creation of a $200 Million Credit

Act 11 mandates the establishment of a $200 million credit within the employer reserve to be divided into individual credit accounts for participating employers on a pro rata basis. These individual credits are then to be used to pay the employer's required unfunded liability payments or, if none are owed, to pay the employer's required current service contributions. After an employer's credit is consumed, the employer is required to resume making full unfunded liability payments and required employer contributions. App. 122, 137-38.

WHY THE PETITION SHOULD BE GRANTED

More than two decades ago, a commentator observed:

> With public employee pension systems absorbing an increasingly large share of state and local revenues, financially troubled governments have begun increasingly to look to these systems as a source of fiscal relief. In some instances, legislatures have sought directly to alter the benefit eligibility structure of a government's pension program; in others, legislatures have sought to influence the fund's investment in government obligations..... Whatever their form, such efforts clearly call into question the protection to be afforded to the public employee in his pension.

Public Employee Pensions in Times of Fiscal Distress, 90 Harv.L.Rev. 992, 993 (1977).

Another commentator has observed that state pension funds are tempting sources of money for State legislatures as an alternative to raising taxes:

> Legislators who want to spend more money than is available prefer to obtain the difference by a method other than raising taxes. Pension trusts for public employees are especially inviting because they frequently have substantial assets. The current trend is to make indirect removals. Approaches include terminating all or part of the plan; reducing benefits; and, suspending, postponing or reducing contributions by the employer.

A Skunk at a Garden Party: Remedies for Participants in State and Local Pension Plans, 79 Denv. U.L. Rev. 507 (1998).

The notorious bank robber, Willie Sutton, when asked why he robbed banks, purportedly answered: "because that is where the money is." For state legislatures, public pension funds are where the money is and, increasingly, perceived short-term fiscal needs are trumping the property rights and long-term retirement security interests of public employees.

In Wisconsin, the legislature has made a number of attempts to tap into the substantial assets of public pension trusts. Prior to the present case, the Wisconsin Supreme Court has, always unanimously and consistently, invalidated all such direct and indirect legislative attempts. *See, e.g.*, Wisconsin Retired Teachers Ass'n v. Employe Trust Funds Bd., 207 Wis.2d 1, 18, 558 N.W.2d 83, 90 (1997), Association of State Prosecutors v. Milwaukee County, 199 Wis.2d 549, 558, 544 N.W.2d 888, 892 (1996), State ex rel. Canon v. Moran, 111 Wis.2d 544, 331 N.W.2d 369 (1983), State Teachers' Retirement Board v. Giessel, 12 Wis.2d 5, 10, 106 N.W.2d 301 (1960). Previously, the Wisconsin Supreme Court has uniformly held that the assets and earnings of the WRS are

irrevocably held in trust for WRS Participants, that participants have a vested property interest in the assets and earnings of their public pension system that cannot be taken without just compensation and due process of law, and that the assets and earnings of WRS or other public pension can only be used as expressly authorized by statute. *Id.*

This Court has held that a State may not sidestep the takings clause by disavowing property interests long recognized under state law. Phillips v. Washington Legal Foundation et al., 524 U.S. 156, 167 (1998), *See, also,* Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 164 (1980). The Wisconsin Supreme Court's decision in the present case represents a radical departure from a long line of precedent protecting the assets and earnings of the WRS, and disavows property rights that are well established under Wisconsin law.

The decision of the Wisconsin Supreme Court is erroneous, conflicts with decisions of this Court, and violates property and contract rights embodied in well settled trust principles. It contributes to a proliferating conflict among state courts concerning constitutional protections related to public pension system assets.

I. CONFLICTS CONCERNING THE PROPERTY AND CONTRACT RIGHTS OF PARTICIPANTS IN PUBLIC PENSION SYSTEMS.

In a radical departure from precedent, a sharply divided Wisconsin Supreme Court held that the vested property and contract rights of WRS Participants is limited to their benefit commitments, and does not extend to the assets and earnings contained in the WRS Trust Fund. The conflict between the justices in the present case mirrors the sharp division that has emerged on this issue among state courts.

In New York the Court invalidated legislation that created a similar credit account that depleted assets of public retirement systems and provided funding as benefits accrued. The mandated change was designed for the sole purpose of

providing the state with budgetary relief, and used the savings generated by the alternate funding method to create a credit for public employers to be used to pay future required employer contributions. The Court invalidated the legislation, stating as follows:

> In sum, chapter 210 impairs the benefits of the existing pension fund. Said legislation allows employers to deplete moneys in the existing pension fund by reducing the amount of employer contributions. Employers are allowed a credit of a portion of the existing moneys, and need not contribute to the pension until the reserved moneys are drastically reduced. To later replenish the fund, employers and employees must increase the amount of their contributions to the pension fund. As such, the reserve moneys will not be available for immediate investment, the return on investment of moneys in the existing fund will be significantly decreased, and the additional security provided by the reserve moneys in the pension funds will be impaired.

McDermott v. Regan, 82 N.Y. 2d 354, 363, 624 N.E. 2d 985, 989-90 (1993).

Courts in the states of West Virginia, California, Washington and Pennsylvania have held that participants have a vested interest in the underlying assets of their pension system. Dadisman v. Moore, 181 W.Va. 779, 790-91, 384 S.E.2d 816, 827-28 (1988) (Participants vested property interest is not limited to their pension benefits, but extends to the underlying assets of their public pension system), Valdes v. Cory, 139 Cal.App.3d 773, 788-89, 189 Cal. Rptr. 212, 224 (1983)(diverting the use of trust fund assets to pay for financial obligations of the state to the retirement system is no different than the state removing money from the public employee trust fund to balance the budget and is unconstitutional), Weaver v. Evans, 80 Wash.2d 461, 495 P.2d 639 (1972), Dombrowski v. City of Philadelphia, 431 Pa. 199, 245 A.2d 238 (1968). Prior to the present case, Wisconsin was among the states holding that the property interests held by Participants in a public pension system are not limited to benefit commitments, but

extends to the underlying assets and earnings of the system. Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 556-57, 559-65, 544 N.W.2d 888, 891-894(1996), State Teachers' Retirement Board v. Giessel, 12 Wis.2d 5, 10, 106 N.W.2d 301, 305 (1960).

There are also states that have held that participants' property interests and contract rights in their pension system are limited to satisfaction of their benefit commitments. The Illinois Supreme Court reached a different result than New York when construing a provision in the Illinois Constitution very similar to that contained in the New York Constitution. McNamee v. Illinois, 173 Ill.2d 433, 672 N.E.2d 1159 (1996). In McNamee, the legislature amended the state pension code so as to lower unfunded liability amounts due from public employers, and provide the state with more favorable financing terms. Plaintiffs filed a complaint contending that this amendment reduced the security of the fund, and thereby violated art. XIII, § 5 of the Illinois Constitution which provides that "[m]embership in any pension or retirement system of the State ... shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired." *Id.* at 436, 1161. The Illinois Supreme Court rejected plaintiffs' claims, and concluded that the Illinois constitution "creates an enforceable contractual relationship that protects only the right to receive benefits," and provides no protection of the method of funding or the underlying assets except to the extent benefits are impaired "by placing a fund on the verge of default or imminent bankruptcy." *Id.* at 446, 1166. Similar holdings have been reached by the Supreme Courts of Michigan and Kansas in Kosa v. Treasurer v. State of Michigan, 78 Mich. App. 316, 292 N.W.2d 452, 460 (1980), Jones v. Board of Trustees Retirement System, 910 S.W.2d 710 (1995).

An aging population cannot have financial security without clarity and protection of its pension property rights. Long term interests in pensions earned by decades of public service should not be subject to short term expediency given legitimacy by judicial tampering with established property interests.

II. THE WISCONSIN SUPREME COURT DECISION IS ERRONEOUS.

The Fifth Amendment to the United States Constitution, made applicable to the States through the Fourteenth Amendment, provides that private property shall not "be taken for public use, without just compensation.." Phillips v. Washington Legal Foundation et al., 524 U.S. 156, 163-64 (1998). The Takings Clause *protects* private property; it does not create it. *Id.* at 164. Thus, in identifying a property interest so protected, this Court looks to "existing rules or understandings that stem from an independent source such as state law." Board of Regents of State Colleges v. Roth, 408 U.S. 564, 577 (1972).

Even though fundamental principles of state property law may define property rights, the Takings Clause nevertheless limits a state's authority to take property without just compensation by redefining preexisting property rights. Thus, "a State, by *ipse dixit,* may not transform private property *into* public property without compensation," Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 164(1980), nor can it "sidestep the Takings Clause by disavowing traditional property interests long recognized under state law." Phillips v. Washington Legal Foundation et al., 524 U.S. 156, 167 (1998). While recognizing that its previously enunciated principles concerning the property rights of Participants as "sound", the *Wisconsin Supreme Court disavows long recognized property* interests by claiming a need to ". . . restate [these principles] in a contemporary context, attempting to articulate a more complete statement of the property interest and rights enjoyed by participants." App. 51.

The Court did not explicitly overrule or reverse its prior holdings; it simply accorded them lip service or disregarded them altogether and declared, contrary to well established jurisprudence on the subject, that the property interest held by WRS Participants is limited to their benefit commitments. The Court then held that since no actual impairment to benefit commitments could be demonstrated by Participants, that no property had been taken. App. 75.

In disavowing the long recognized property rights of WRS Participants in the underlying assets and earnings of the WRS., the Wisconsin Supreme Court also violated this Court's long established takings jurisprudence. Phillips v. Washington Legal Foundation et al., 524 U.S. 156, 167 (1998), *See, also,* Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 164 (1980).

The Wisconsin Court also ignored the principle that while the legislature may prescribe procedures to be observed in the taking of private property for public use, any such procedure which results in the taking of private property without the payment of just compensation violates the due process clause. Chicago, B. & Q. R. Co. v. City of Chicago, 166 U.S. 226, 236-37 (1897).

A. WRS PARTICIPANTS HAVE A VESTED AND CONSTITUTIONALLY PROTECTED PROPERTY INTEREST IN THE ASSETS AND EARNINGS CONTAINED IN THE PUBLIC EMPLOYE TRUST FUND.

WRS Participants have a vested property interest in all the assets and earnings of the WRS in addition to their benefit commitments. This has long been recognized under Wisconsin law. Wisconsin Retired Teachers Ass'n v. Employe Trust Funds Bd., 207 Wis.2d 1, 18, 19, 558 N.W.2d 83, 90 (1997), Association of State Prosecutors v. Milwaukee County, 199 Wis.2d 549, 556-65, 544 N.W.2d 888, 891-894 (1996), App. 159. State Teachers' Retirement Board v. Giessel, 12 Wis. 2d 5, 106 N.W.2d 301, 304, 305 (1960) (Giessel).

In Giessel, a unanimous Wisconsin Supreme Court invalidated legislation directing that $18,737 of the cost of a government study on retirement systems be paid for with assets of the Wisconsin Retirement Fund (the WRS predecessor). Defendant argued that the participants do not have a vested right in the assets of the fund until such time as those assets are credited to an individual participants' account. The Court rejected Defendant's position and held that participants have a vested interest in the proper use of all the assets and earnings of

their pension system. *Id.* at 11, 305. This principle has been expressly extended to the earnings on assets contained in the WRS. Wisconsin Retired Teachers Ass'n v. Employe Trust Funds Bd., 207 Wis.2d 1, 19, 558 N.W.2d 83, 91 (1997).

The Wisconsin Supreme Court has stated as follows:

> Any pension plan's ability to meet its obligations can be jeopardized when funds are taken from it, since every dime is arguably part of a management strategy dependent upon spreading the fund's monies as broadly as possible.
>
> ***
>
> The Association argues that the transfer of funds prescribed by § 978.12(5)(c)5 will not affect the benefits paid to any retiree or member of the County Plan. The Association contends that, since the contributions to be transferred make up less than one-third of one percent of the County Plan's net assets, the transfer will not diminish or "take" the benefits of County Plan employees and retirees.
>
> We disagree. Governmental takings do not become exempt from due process requirements simply because they may be actuarially insignificant. Wisconsin Stat. § 978.12(5)(c)5 orders Milwaukee County to transfer funds from the County Plan to the State Plan. This transfer takes funds directly out of the County Plan trust fund. The gravity of a property deprivation is irrelevant to the question of whether such rights are violated without due process. Goss v. Lopez, 419 U.S. 565, 576, 95 S.Ct. 729, 737, 42 L.Ed.2d 725 (1975).
>
> ***
>
> While the specific transfer of trust funds pursuant to Wis.Stat. § 978.12(5)(c)5 may not

> immediately threaten the benefits of vested County Plan beneficiaries, the precedent set by such a transfer certainly could. ...
>
> In the present case, the legislature could have easily provided service credits to its new employees under the State Plan, and funded the resulting larger retirement pensions with state money. Instead, the legislature chose to give the service credits, but to pay for the larger pensions by transferring money out of the County Plan. This it cannot do. In the present case, **the state cannot simply "reach" into the County Plan to pay for obligations it has incurred**. Vested County Plan beneficiaries have protectable property interests in the integrity and security of their retirement fund. Because Wis.Stat. § 978.12(5)(c) deprives the beneficiaries of this protectable interest, the statute takes property without due process of law.

Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 556-57, 559-65, 544 N.W.2d 888, 891-894(1996) (emphasis added).

The monies in the Trust Fund have been irrevocably placed in trust for the benefit of WRS Participants and annuitants, and the State cannot direct the use of such money for non-Trust purposes. App. 142, Wisconsin Retired Teachers Ass'n v. Employe Trust Funds Bd., 207 Wis.2d 1, 18, 558 N.W.2d 83, 90 (1997). The State has not retained any right to alter the terms of the Trust. *Id.* at 19, 23, 91, 93. In the absence of specific provisions reserving for Participating Employers rights and/or beneficial interests in assets and earnings of the Trust Fund, no such rights or beneficial interests exist, and none can be imposed by the legislature. *See e.g.* Wisconsin Retired Teachers Ass'n v. Employe Trust Funds Bd., 207 Wis.2d 1, 558 N.W.2d 83 (1997) 76 Am. Jur. 2d, Trusts § 322 (2000)(Trusts are to be administered in accordance with the terms of the trust, and neither a court, nor a beneficiary, nor the legislature has the authority to modify or abrogate the terms of

a trust), George G. Bogert & George T. Bogert, The Law of Trusts & Trustees § 42, at 431-33 (2d ed. 2000) (The settlor has no further interest in anything conveyed to the trust except to the extent of expressly reserved rights).

The Wisconsin Supreme Court has held that Legislative intervention into the Trust Fund that is not authorized by Chapter 40 Wis. Stats. is only constitutional in limited circumstances "when it is necessary to preserve the actuarial soundness of a plan or to salvage financially troubled funds." To be constitutional, legislative intervention must be "necessary to protect actuarial soundness." Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 558, 544 N.W.2d 888, 892 (1996).

The Court adopted the stipulation of the parties that the Trust Fund is not financially troubled, and the provisions of Act 11 herein were not needed to protect the actuarial soundness of the Trust Fund. App. 121, 135. The Court then turned the existing standard on its head, and gave the legislature license to do as it pleases so long as actuarial soundness is not transgressed. This effectively establishes a means test for a taking: If the trust fund remains "actuarially sound" the taking passes constitutional muster. The court refused to honor its basic precedent that the assets of the trust belong to the beneficiaries of the trust. A bull market does not change that.

B. THE CHALLENGED LEGISLATION TAKES THE PROPERTY OF WRS PARTICIPANTS WITHOUT JUST COMPENSATION AND DUE PROCESS OF LAW.

Common sense and candid legal analysis yields no doubt that the challenged provisions of Act 11 "takes" $200 million of the earnings on Participants' WRS assets and uses such earnings to pay financial obligations of public employers who have no property right or beneficial interest in the assets and earnings of the WRS.

The Act 11 "credit" is unprecedented and without such credit provisions, trust assets would not be applied toward

participating employers' required payments. Instead, the $200 million would be part of the total balance of the employer reserve and would be used to purchase annuities for WRS Participants upon retirement. App. 123.

The credit account provisions result in a very significant and immediate reduction in employer contribution rates and a corresponding $200 million reduction in Trust Fund assets. The Wisconsin Department of Employee Trust Funds made preliminary calculations of the effect that the $200 million credit will have on each category of participating employer, and a chart reflecting those effects is contained in the stipulation of facts and included in the Appendix at 274.

As reflected in the stipulated chart, using the credit account to pay the State employers' obligations for unfunded liability will result in State employers being relieved from such unfunded liability payments for an average of 22.1 months. This represents an aggregate savings to State employers of approximately 56.3 million dollars -- an amount which State employers would otherwise have an absolute obligation to pay into the WRS over the next 22.1 months. County employers enjoy respite from their unfunded liability payments for a period of 22.8 months, and result in an aggregate savings to such employers of $24.7 million, and School Districts are relieved of unfunded liability payments for an average of 19.6 months, for a total savings to such employers of $84 Million.

Clearly, the $200 million employer credit account provides a benefit solely to participating employers. On average, each participating employer's share of relief from the $200 million credit account pays the required payments for between 19.6 and 58.2 months. App. 274.

There is no legitimate trust purpose being served by the employer credit account. The assets of the Trust Fund may only be used to fulfill benefit commitments to WRS Participants, as set forth in Chapter 40, and "shall not be used for any other purpose." App. 102, 142. "Contributions placed in the [employer] accumulation reserve are [to be] applied solely to the payment of fixed monthly annuities [to Participants upon

their retirement]..." Association of State Prosecutors v. Milwaukee County, 199 Wis. 2d 549, 556, 544 N.W.2d 888, 890 (1996). The provisions of Chapter 40 governing the payment of unfunded liability provide (1) that employer payments for unfunded liability are to be amortized over 40 years; (2) that an employer's payments for unfunded liability must be made until paid in full; and (3) that employers may pay contributions for unfunded liability in advance. App. 114-15, 157-58. Nowhere does Chapter 40 authorize the use of assets of the Trust Fund to pay or defer employer required contributions for unfunded liabilities or current service contributions.

C. THE TAKING OF PRIVATE PROPERTY WITHOUT JUST COMPENSATION AND DUE PROCESS OF LAW IS NOT LEGITIMIZED BY THE USE OF AN INDIRECT OFFSET.

The Wisconsin Supreme Court's decision herein gives lip services to the property rights of WRS Participants, but concludes that the property of WRS Participants was not taken because the employer credit account does not physically remove any assets from the WRS. The analysis of the Wisconsin Supreme Court places form over substance and cannot withstand scrutiny.

The Court, in its decision herein, states as follows:

> **Once contributions enter the employer reserve, they no longer belong to employers and may not be reclaimed by employers.** They are assigned to participants. **Non-annuitant participants have the right to block improper diversions from the employer reserve** and to protect the integrity and security of the employer reserve so that benefit commitments will be fulfilled.

App. 79 (emphasis added).

Thus, it is clear that the legislature cannot lawfully direct that $200 million of the assets contained in the Employer Reserve be returned to participating employers for any purpose because neither the State nor the participating employers have or retain any property interest in the assets contained in the Employer Reserve. The Wisconsin Supreme Court held that this proscription was avoided in the present case because the legislature did not physically remove the funds and return them to participating employers, but rather, directed that such funds be used to pay financial obligations of participating employers. App. 79. It is respectfully submitted that the constitutional protection afforded by the takings clause cannot be so easily circumvented.

While the fungibility of money makes it possible to manipulate the WRS in a manner that causes those other than Participants and annuitants to receive the benefit of assets in the Trust Fund without physically removing such assets from the WRS, that does not make such schemes legitimate. Courts have long recognized that there is no distinction between directly removing money from a fund, and using the indirect method of setoff to achieve the same result.

For example, Raskin v. Moran, 684 F.2d 472 (7th Cir.1982) involved a constitutional challenge to a Wisconsin statute which reduced the salary of certain reserve judges by the amount of federal social security benefits they received. Under § 203(f)(3) of the Social Security Act, these judges were entitled to social security benefits without a reduction based on earned income. The Seventh Circuit held there was a constitutional impairment based on the supremacy clause, holding as follows:

> Although not directly preventing or impeding plaintiffs' receipt of social security benefits, Wisconsin effectively deprives the recipient of those federal benefits by reducing plaintiffs' salaries in an amount precisely equal to the federal benefits. Indeed, we would put form over substance if we held that only direct efforts to reduce, divert or eliminate social security benefits were in conflict with section 203(f)(d)....

Id. at 477-78 (footnotes omitted).

In a later Wisconsin state case involving the use of a setoff to reduce public pension benefits, the Supreme Court of Wisconsin reached a similar result. State ex rel. Canon v. Moran, 111 Wis. 2d 544, 331 N.W.2d 369 (1983) ("Canon"). In Canon, certain circuit court judges brought an action challenging the constitutionality of a statute which operated to reduce their state salaries by the amount of county pension benefits they were receiving by virtue of their prior judicial service when employed by the county. The Plaintiffs argued that the offset impaired their contract rights under the county pension system because it violated the statutory prohibition against reducing their pension benefits, and thereby deprived them of property without due process of law. The defendants argued that since the legislation at issue "did not reduce or eliminate the Plaintiffs' pension benefits, the obligations of [their pension contract] were not impaired." *Id.* at 555, 375. The Wisconsin Supreme Court rejected the Defendants arguments, and stated as follows:

> The defendants argue, and the court of appeals held, that since Chapter 38 did not reduce or eliminate the plaintiffs' pension benefits, the obligations of their MCERS contracts were not impaired. We disagree. The distinction drawn by the defendants and the court of appeals between a deprivation of pension benefits and a reduction in salary by the same amount is illusory.

Id.; See, also, Valdes v. Cory, 139 Cal.App.3d at pp. 773, 788-89 (Ct.App. 1983):

> Had the Legislature actually appropriated any of the PERS [Public Employees' Retirement System] trust funds for purposes unrelated to the benefit of PERS members, e.g., to balance the state budget and avoid a year-end deficit, we would have no difficulty concluding that such legislative action modified vested rights of PERS members. When instead the Legislature directs that funds held in trust for the exclusive benefit

> of the members and beneficiaries of PERS be used to satisfy the state's contractual obligations to make monthly contributions to the retirement fund so that monies regularly appropriated for that purpose can irretrievably be redirected to balance the state budget, the effect is precisely the same, i.e., vested rights of PERS members are impaired.".

The reasoning of the above cited cases is applicable to the present case. There is no substantive difference between giving participating employers a $200 million dollar credit on their obligations to the Trust Fund, and transferring $200 million out of the Trust Fund into the pockets of participating employers.

D. THE HOLDING OF THE WISCONSIN SUPREME COURT VIOLATES WELL SETTLED TRUST PRINCIPLES

Section 40.01(2), Stats. provides as follows:

> The **public employe trust fund** is a **public trust** and shall be managed, administered, invested, and otherwise dealt with **solely for the purpose of ensuring the fulfillment** at the lowest possible cost **of the benefit commitments to participants, as set forth in this chapter, and shall not be used for any other purpose**.

App. 142 (emphasis added).

Rights to trust property are determined by the trust instrument, which in the present case, consists of the provisions of Chapter 40 of the Wisconsin Statutes. App. 142. The settlor of a trust has no further interest in anything conveyed to the trust except to the extent of expressly reserved rights. George G. Bogert & George T. Bogert, The Law of Trusts & Trustees § 42, at 431-33 (2d ed. 2000). If nothing has been reserved, the settlor has no right to remove assets from the trust, and has no right to use trust assets. *Id.* Chapter 40 does not grant or preserve any property rights in favor of participating employers – such assets must remain in the trust and be used solely to

fulfill benefit commitments to Participants. App. 102, 142.

The Wisconsin Supreme Court conspicuously skirts the fundamental issue in this case. To whom do the assets in the WRS belong? The Court clearly states that participating employers have no property interest in the assets of the WRS, and that such assets are "assigned to participants." App. 79. Then the court states that participants' property interest is limited to their benefit commitments. The Wisconsin Supreme Court apparently thinks that nobody has a property interest in the funds contained in the WRS until they are need to pay an active annuity. In the interim these funds appear to be up for Legislative grabs. Legislators who lack vision, or concern beyond the next election, should not be given license to raid public pension systems in order to defer difficult short term decisions in exchange for long term public difficulties or long cherished constitutionally protected values.

E. ACT 11 IMPAIRS THE CONTRACT RIGHTS OF WRS PARTICIPANTS.

The United States Constitution prohibits the passage of laws which impair the obligations of contract. U.S. Const. Art. I, § 10. The contracts clause limits the power of a state to modify its own contracts with other parties. United States Trust Co. v. New Jersey, 431 U.S. 1 (1977). The most basic purposes of the Contracts Clause, as well as the notions of fundamental fairness that transcend the clause itself, point to these simple principles: the state must keep its promises, and it may depart therefrom only for a significant and legitimate public purpose. *Id.* at 26. Such a public purpose must amount to something more than providing states with budgetary relief. *Id.* ("If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all.").

The vested contract right of WRS Participants is established by Section 40.19(1), Stats., which expressly provides that "rights exercised and benefits accrued to an employee under this chapter [40] for service rendered are **due**

as a contractual right and may not be abrogated by any subsequent legislative act." App. 159 (emphasis added). Section 40.19(1) gives Participants vested contractual and property rights in the WRS. Wisconsin Retired Teachers Ass'n v. Employe Trust Funds Bd., 207 Wis.2d 1, 18-20, 558 N.W.2d 83, 91 (1997).

Act 11 impairs the contract rights of WRS Participants in three respects. First, it forgives $200 Million of the unfunded liability debt owed to the WRS by Participating Employers without removing the underlying obligation of the WRS to pay benefits to Participants for the period of time prior to their participation in the WRS. Chapter 40 does not permit the forgiveness of participating employers' debt for unfunded liabilities, and to do so, violates the WRS contract. App. 157-158, 235-47. The impairment is substantial because it results in Participants being deprived of $200 Million in assets in which they have a vested property interest, results in the WRS paying for benefits for which it did not receive the promised contributions, and opens the door to future legislative grabs that undermine the security of the WRS.

Furthermore, there is no legitimate public purpose being served by Act 11 – other than the Court's brazen statement declaring the purpose of the credit account as being "to provide 1,200 government employers (and taxpayers who support them) respite from employer required contributions." App. 75.

Second, Act 11 abrogates the provisions of Chapter 40 which provides that the assets of the WRS are held in Trust for the exclusive purpose of satisfying benefit commitments to WRS Participants. By directing that the assets of the system be utilized for purposes of paying a debt owed by participating employers, Act 11 violates the WRS contract.

Third, Act 11 violates that portion of the WRS contract which requires that the fund shall be maintained as a qualified plan for federal income tax purposes, and prohibits administration of the plan in a manner that will violate the qualification rules of the Internal Revenue Code. App. 143. Under the IRS rules for qualified plans, it must be impossible

"for any part of the corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of [participating] employees or their beneficiaries." 26 USCA 401(a), Treas. Reg. 1.401-2(a)(2)-(3), App. 162, 163. Act 11 clearly violates this proscription by diverting and using assets of the Trust Fund for the purpose of paying employer required contributions -- a purpose that is not for the benefit of participating employees or their beneficiaries. It is difficult to imagine how taxpayers get "respite from employer required contributions" without violating the qualification rules of the Internal Revenue Code.

For all the foregoing reasons, the Court should grant the petition.

Respectfully submitted,

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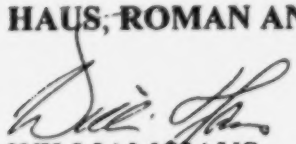

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